P-501, 421/CP-90-357 ORDER REQUIRING REVISED COST STUDIES AND PROPOSED RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner
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In the Matter of a Petition for Extended Area Service From the Bena Exchange to the Cass Lake and Bemidji Exchanges

ISSUE DATE: September 17, 1991

DOCKET NO. P-501, 421/CP-90-357

ORDER REQUIRING REVISED COST STUDIES AND PROPOSED RATES

PROCEDURAL HISTORY

On May 14, 1990, subscribers from the Bena exchange of Arrowhead Communications Corporation (Arrowhead) filed a petition for extended area service (EAS) to the Cass Lake and Bemidji exchanges of U S West Communications, Inc. (USWC). Cass Lake and Bemidji have EAS to each other. Bena is adjacent to the Cass Lake exchange, but not to the Bemidji exchange.

On June 22, 1990, the Minnesota Department of Public Service (the Department) established a schedule for the filing of traffic studies, cost studies, and proposed rates. The Department based this schedule on the current EAS Rule (Minn. Rules pt. 7815.0700 - 7815.1500).

On July 27, 1990, USWC filed a request for a variance to process this EAS petition according to the new EAS law, rather than the EAS rule.

On August 7, 1990, Arrowhead's accounting firm filed traffic studies for the Bena to Cass Lake and Bena to Bemidji EAS routes.

On October 8, 1990, USWC filed cost studies and proposed rates for only the Bena/Cass Lake EAS route.

On December 17, 1990, the Commission issued its ORDER REQUIRING THE FILING OF COST STUDIES AND PROPOSED RATES. In this Order, the Commission found that the Bena EAS petition met the adjacency and traffic requirements of the EAS statute, Minn. Stat. § 237.161 (1990). In anticipation of setting EAS rates prior to polling Bena subscribers to determine the level subscriber support for the EAS petition, the Commission directed the affected telephone companies (Arrowhead and USWC) to file cost studies and proposed rates.

On March 15, 1991, Arrowhead and USWC submitted their cost studies and proposed rates.

On March 27, 1991, the Commission issued an Order granting the Department 45 days from the date of the companies' filings to file its report and recommendation.

On May 17, 1991, the Department submitted its report and recommendation.

On June 7 and June 11, respectively, Arrowhead and USWC filed response comments.

On August 20, 1991, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

I. Traffic Studies: the Basis for Reliable Cost Studies

The Commission seeks to expedite the processing of the EAS petitions brought before it, but must do so consistent with its statutory obligations to set fair and reasonable rates [Minn. Stat. § 237.06 (1990)], rates which render the affected telephone companies income neutral [Minn. Stat. § 237.161, subd. 2 (b) (1990)]. In order to set such rates, the companies must provide reasonably accurate studies projecting the costs involved in providing the proposed EAS route: Bena to the local calling area consisting of the Cass Lake and Bemidji exchanges.[1]

Reliable cost studies, in turn, require the best possible data regarding traffic volume. Overestimation of traffic volume would result in the companies over-collecting access contribution until the Commission re-evaluated the EAS rates based on actual traffic volume in the settle up procedure. Inflated traffic volume would also lead to excessive investment in EAS facilities.

Unfortunately, the traffic data used by Arrowhead and USWC as the basis for their cost studies in this case is inadequate. In a method used by both companies, actual traffic from only one month was simply multiplied by 12 to estimate yearly figures. USWC

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[1] This matter involves only one route: Bena to the Cass Lake-Bemidji local calling area. This route meets the adjacency requirement of Minn. Stat. § 237.161, subd. 1 (a) (2) (1990) because Bena, being adjacent to the Cass Lake exchange, is adjacent to the Cass Lake-Bemidji local calling area. The Commission has not approved a separate Bena to Bemidji EAS route because the Bena and Bemidji exchanges are not adjacent.

also used a second method which also produces unreliable data.[2] Moreover, Arrowhead and USWC each chose a different time period to conduct their traffic studies and applied dissimilar traffic collection techniques. As a consequence, the companies' traffic estimates varied by 30%.

To correct these deficiencies, the Commission will require the companies to consult with each other and the Department to select a dependable and uniform traffic study methodology (including, for example, the same traffic study period) that they will both employ. In seeking dependable traffic projections, the Commission will not require the companies to use 12 months of actual data, as the Department recommends. Twelve months of data is difficult and time consuming to obtain and may not greatly improve the accuracy of current estimates. It is essential, however, that the companies use the same and the best methodology available.

In addition, to assure the coordinated approach to traffic studies, the Commission will also require the companies to consult with each other and the Department after a uniform traffic study methodology is selected and before conducting the traffic study according to the new methodology to further verify uniformity of approach. Finally, the Commission will require the companies to identify the traffic study methodology and study period used to determine the traffic volumes in their refiled cost studies.

II. Cost Study Issues

A. Lost Toll Contribution

Cost studies should include and proposed rates should recover lost toll contribution, not all lost toll revenue. The EAS statute requires rates that render the affected telephone companies income neutral, not revenue neutral. Minn. Stat. § 237.161, subd. 2 (b) (1990).

B. Stimulation Factor

It is anticipated that if EAS becomes available between the Bena, Cass Lake and Bemidji exchanges, the availability of EAS will stimulate subscribers in these exchanges to increase the number and duration of calls that formerly would have been toll calls. To calculate the amount of facilities and operating costs that will be required to provide the requested EAS, it is necessary to estimate the level of EAS calling that will occur once EAS is installed. The percentage increase in such calling occasioned by

[2] USWC's second method is called Sampled Traffic Analysis and Report System (STARS). STARS takes a 5% sample of traffic during six to 12 months and multiplies the sample by 20.

the switch to EAS translates into an EAS stimulation factor. The EAS rate must properly take into account the amount of facilities and operating expenses that will be necessary to accommodate this increased calling.

Although there is little empirical substantiation, all parties currently agree that a 400% stimulation factor is reasonable. The Commission will require the companies to file cost studies and proposed rates using that stimulation factor. However, in part because the stimulation factor is questionable, the Commission will require a settle up procedure after EAS is established and in operation to adjust rates based on the stimulation that actually occurs.

C. Gross Receipts Tax

In a number of recent EAS cases, the Commission has decided that cost studies should be based on the 1% gross receipts tax in effect during 1991.[3] The Commission finds no reason to depart from this level and will order the companies to use that factor in the cost studies required by this Order, as well.

III. Rates Issue: Cost Allocation

The EAS statute requires the Commission to allocate between 50% and 75% of the cost of EAS to the petitioning exchange. Minn. Stat. § 237.161, subd. 3 (1990). In this case, there is no dispute that Bena is the petitioning exchange. However, the Commission need not decide at this time what percentage of EAS costs (between 50% and 75%) it will allocate to the petitioning exchange.

Instead, the Commission will require the companies to file two sets of proposed rates for the proposed route. One set will allocate 50% of the costs to the petitioning exchange; the other will allocate 75% of the costs to the petitioning exchange. With the exact rates at hand, the Commission will be in a better

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[3] The Commission adopted the 1% gross receipts level in setting rates for the metropolitan area exchanges and for all the non-metropolitan exchanges considered to-date: North Branch, Buffalo, Cambridge, Delano and Lindstrom. See, e.g. <u>In the Matter of the Petition of Certain Subscribers in the Lindstrom Exchange for Extended Area Service to the Minneapolis/St. Paul Metropolitan Calling Area</u>, Docket No. P-407, 421/CP-86-526, ORDER REQUIRING REFILED COST STUDIES AND INFORMATION REGARDING LOWER COST ALTERNATIVE (July 31, 1991). See also <u>In the Matter of the Petition for Extended Area Service From Iron Trail United Communities</u>, Docket No. P-421, 407/CP-87-747, ORDER REQUIRING REVISED TRAFFIC STUDIES, COST STUDIES AND PROPOSED RATES FOR TWELVE SPECIFIED ROUTES (September 17, 1991).

position to see how these rates would affect the Bena subscribers and will be better able to prescribe rates that treat them most fairly, within the statutory framework.

IV. Settle Up Filing

As previously noted, the actual amount of traffic that will be stimulated between these three exchanges if EAS is installed is unknown, making it impossible to determine precisely what level of toll contribution to include in the rates. Most likely, therefore, the EAS rates established for these exchanges before polling will not leave the affected telephone companies income neutral as required by Minn. Stat. § 237.161, subd. 3 (b) (1990). To assure that the EAS rates are adjusted as soon as possible to render the companies income neutral, the Commission will direct Arrowhead and USWC to make a settle up filing within one year of the installation of EAS between these exchanges.

In their settle up filings, the companies will indicate what modifications in EAS rates, if any, need to be made to render the companies income neutral. To promote the comparability and accessibility of the companies' settle up reports, the Commission will require them to address the topics delineated for settle up treatment in the Commission's March 8, 1991 ORDER AFTER RECONSIDERATION OF THE COMMISSION'S JANUARY 25 AND FEBRUARY 1, 1991 ORDERS AND ORDER ESTABLISHING RATE in the Metro EAS Case. The reports will take into consideration actual lost access contribution for calls between exchanges that have received EAS and any cost savings associated with more than one exchange receiving EAS. The companies will report their actual experience regarding the gross receipts tax, growth stimulated due to EAS, access contribution lost due to EAS, and investment transferred to EAS.

ORDER

1. Prior to conducting the traffic studies that will be the bases for their cost studies filed in accordance with Ordering Paragraph 3, Arrowhead Communications Corporation (Arrowhead) and U S West Communications, Inc. (USWC) shall work with the Minnesota Department of Public Service (the Department) to develop a more accurate traffic study methodology. The new traffic study methodology shall include the same parameters for both companies, e.g. same time period for collection of data and the same traffic data collection techniques for both companies.

2. After jointly selecting the traffic study methodology that they will use but prior to actually conducting their traffic studies according to the new method, Arrowhead and USWC shall consult with each other and the Department.

3. Within 45 days of this Order, Arrowhead and USWC shall refile cost studies and proposed rates for the EAS route between the Bena exchange and the Cass Lake-Bemidji local calling area. The cost studies shall:

   a. include a narrative explanation of the methodology used to collect the traffic data upon which the cost studies are based, including a summary of any discussions regarding the traffic study methodologies that took place between the Department and the companies;

   b. meet all the requirements of Minn. Stat. § 237.161;

   c. include only lost toll contribution rather than all lost toll revenue;

   d. use and state that it uses a stimulation factor of 400%;

   e. use a gross receipts tax factor of 1%;

   f. include two rate design alternatives: one placing 75% of the costs on the Bena exchange with 25% placed on the Cass Lake and Bemidji exchanges and the other placing 50% of the costs on the Bena exchange with 50% placed on the Cass Lake and Bemidji exchanges; and

   g. include an estimate of the one-time, non-recurring polling costs for the Bena exchange.

4. Within 45 days following the filing of the companies' revised cost studies and proposed rates pursuant to Ordering Paragraph 3, the Department shall file its report and recommendation regarding the new cost studies and proposed rates with the Commission, Arrowhead, USWC and the petition sponsor. The Department's report shall include its recommendation regarding the rates that should be included on the ballots.

5. Within 20 days after the Department files its report pursuant to Ordering Paragraph 4, the parties may file comments on the report.

6. Within one year after the implementation, if any, of EAS between the Bena, Cass Lake and Bemidji exchanges, Arrowhead and USWC shall make a settle up filing with the Commission and serve a copy on the Department, each other, and the petitioner. In their settle up filings, the companies shall identify what modifications in EAS rates, if any, are required to achieve income neutrality in light of actual lost access contribution for calls between the exchanges and the actual level of stimulation that has occurred in the exchanges. The companies shall report their actual experience regarding the gross receipts tax, growth stimulated due to EAS , access contribution lost due to EAS, and investment transferred to EAS.

7. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

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